Macro Brazil

June 27, 2024

Quarterly Inflation Report: stable Selic rate scenario remains; 12 new studies

- The June 2024 Inflation Report (IR) presented inflation projections for 2024 and 2025, already published in the latest Copom minutes, that were higher than in the previous IR (revised to 4.0% from 3.5% and to 3.4% from 3.2%, respectively). In our view, this scenario reinforces the view that the Selic rate will remain in contractionary territory, since inflation estimates are above the target. We expect the Selic rate to remain stable at 10.50% this year and in 2025.

- The report brought a large number of new studies and estimates, contained in 12 boxes. The GDP growth estimate for 2024 increased from 1.9% to 2.3% (in line with our estimate), impacted by positive surprises in the first quarter, particularly household consumption, investments (GFCF) and taxes. The estimate also incorporates the monthly indicators available for the second quarter, which point to a slowdown in economic activity, including the impact of the floods in Rio Grande do Sul (discussed in more depth in one of the IR boxes). There was also a slight improvement in new loans forecasts for 2024 (to 10.8% from 9.4%), driven by increases in both household and corporate credit.

- In addition to the above-mentioned usual revisions, the report brought important updates to estimates of the output gap, neutral interest rate and the BCB's small semi-structural models. Regarding the output gap, the latest Copom minutes had signaled that, previously, it was slightly negative, and now is around neutrality. In one of the studies, the text shows that the set of output gap estimates presents a high amplitude, also standing out the high correlation between the various measures. Regarding neutral real interest rate measures in Brazil, the study concludes that, after reaching a low with the outbreak of the Covid-19 pandemic, the majority of estimated rates have shown an upward trend – with the median of estimates increasing to 5.0% from 4.8%. In addition, the central bank updated information on small semi-structural models. According to the text, the estimated parameters had little change compared to previous versions.

- In two other studies, the BCB analyzes (in addition to making new databases available) the recent dynamics of growth in the export exchange rate gap, concluding that there is no substantial volume of foreign currency held abroad by exporters with the potential to significantly impact the exchange rate dynamics.

Central Bank forecasts

The table below shows the inflation estimates released for the IR reference scenario.

BCB's IPCA Inflation Forecasts*				
	Inflation target	March report	June report	Difference (p.p.)
2024	3.00%	3.5%	4.0%	0.5
2025	3.00%	3.2%	3.4%	0.2
2026	3.00%	3.2%	3.2%	0.0

*Scenario considering the Selic rate extracted from the Focus survey and exchange rate evolving according to the PPP.

Source: Central Bank.

Compared to the estimates presented in the March IR, inflation forecasts advanced to 2024 and 2025 (to 4.0% from 3.5% and to 3.4% from 3.2%, respectively). For 2026, the estimate remained stable at 3.2%, still above the target (3.0%). In our view, this scenario reinforces the view that the Selic rate will remain in contractionary territory, since inflation estimates are above the target. We expect the Selic rate to remain stable at 10.50% this year and in 2025.

Consumer price inflation was slightly higher than expected by the BCB in the quarter ended in May, with a surprise associated with food prices (+0.14 p.p. above previously expected). Regulated prices were in line with expectations, with an upward surprise in gasoline being offset by lower variations in electricity and pharmaceutical products. Services inflation also came in line with expectations, as well as underlying services. Prices of industrial goods, in turn, were below expected in most items, with the exception of ethanol.

In relation to other variables, the GDP growth estimate for 2024 increased to 2.3% from 1.9% (in line with our forecast). According to the report, the revision was impacted by positive surprises in the first quarter, particularly household consumption, investments (GFCF) and taxes. The projection also incorporates the monthly indicators available for the second quarter, which point to a slowdown in economic activity, including the impact of the floods in Rio Grande do Sul. In relation to this issue, the BC estimates, with a high degree of uncertainty, that the climate tragedy in RS will have a modest impact on the annual growth of national GDP. The negative effects should be concentrated in the second quarter and offset by reconstruction efforts and the extraordinary acquisition of capital goods, durable goods and clothing, which should occur mainly in the second half of the year. It is noteworthy, however, that the sectoral impact can be quite heterogeneous.

Regarding other revisions, there was a slight improvement in new loans forecasts for 2024 (to 10.8% from 9.4%), driven by increases in both households and corporations. Furthermore, there was a worsening in projections for the current account, to a deficit of US$ 53 billion (from a deficit of US$ 48 billion in the previous scenario), with a worsening in service and primary income accounts.

Gross domestic product forecasts for 2024 (accumulated in the year)

	September	December	March	June
GDP (current prices)	1.8%	1.7%	1.9%	**2.3%**
Agriculture and livestock	1.5%	1.0%	-1.0%	**-2.0%**
Industry	2.0%	1.7%	2.2%	**2.7%**
Services	1.8%	1.9%	2.0%	**2.4%**
Household consumption	1.9%	2.3%	2.3%	**3.5%**
Government consumption	1.5%	1.1%	1.9%	**1.8%**
Gross fixed capital formation	2.1%	1.0%	1.5%	**4.5%**
Exports	1.5%	1.5%	0.5%	**0.5%**
Imports	1.6%	2.5%	3.0%	**6.0%**

Source: Central Bank.

Credit balance forecasts for 2024 (12-month change)				
	September	December	March	June
Total	8.5%	8.8%	9.4%	**10.8%**
Non-earmarked	7.9%	8.1%	8.9%	**10.0%**
Households	8.5%	9.0%	10.0%	**11.5%**
Corporations	7.0%	7.0%	7.5%	**8.0%**
Earmarked	9.3%	9.7%	10.0%	**12.0%**
Households	10.0%	10.0%	10.5%	**10.5%**
Corporations	8.0%	9.0%	9.0%	**15.0%**
Total households	9.2%	9.4%	10.2%	**11.0%**
Total corporations	7.4%	7.7%	8.0%	**10.5%**

Source: Central Bank.

External accounts forecasts for 2024 (USD billion)				
	September	December	March	June
Current account	-37	-35	-48	**-53**
Trade balance	71	73	59	**59**
Exports	348	343	330	**335**
Imports	277	270	271	**276**
Services	-40	-40	-40	**-43**
Primary income	-68	-68	-68	**-71**
Investment - liabilities	85	80	80	**75**

Source: Central Bank.

Summary of the IR studies

We present below summaries of the studies published in the IR, as well as the link for the complete reports.

- ### Initial impacts of floods on economic activity in RS state
  Full study (only in Portuguese) here.

  - This study evaluates the initial impacts of floods on economic activity in Rio Grande do Sul based on a set of timely indicators. To this end, the BC considered i) payment flows received by companies domiciled in RS via debit card or Pix, ii) invoice issuance data, compiled by the RS Finance Department (SEFAZ/RS) and iii) FGV's surveys with consumers and businesses.

  - At the beginning of the floods (May 1st to 7th), there was an 8.6% drop in the number of retail businesses and services provided to families that received payment via debit card or Pix. However, in the last week analyzed (June 5th to 11th), this number exceeded that observed in the base period by 2.6%, suggesting a relatively quick recovery in sales. Data from SEFAZ/RS show that in the first fortnight of May, sales by industries in RS fell 29.8% compared to the same period of the previous year. By sector, the segments that contributed most to this drop were metalworking, agroindustry and agricultural inputs. Finally, surveys with consumers and businesses show a significant decline in the region, especially in consumer confidence in Porto Alegre. Conventional indicators were also used to measure the impact of floods on agriculture, livestock and foreign trade.

- In conclusion, these timely indicators highlight the significant drop in the level of local activity in May, with significant heterogeneity between sectors and segments, in addition to preliminary signs of ongoing recovery

Demographic changes and recent developments in the labor force participation rate

Full study (only in Portuguese) here.

- Four years after the pandemic outbreak, the participation rate in Brazil has not returned to the level at the end of 2019. In addition to the traditional reasons for this movement – such as the anticipation of retirements and government transfers – the box sought an explanation in light of demographic changes, which has increased the percentage of people in higher age groups, in which the participation rate is lower.

- According to the analysis, approximately half of the 1.3% decline in the participation rate since 4Q19 was due to changes in population composition. Looking ahead, given the continued aging of the population, it is expected that, in ten years, changes in population composition will contribute with -2.8 p.p. of the change in the participation rate.

- In an international comparison, the composition effect was negative for most countries. Brazil is one of the few whose contribution from the intra-group effect – which captures changes in the participation rate not associated with population composition – is in negative territory post-pandemic.

- Finally, it is noted that the Brazilian participation rate at the beginning of 2024 (62.1%) is below its historical average (62.9%). Excluding the population composition effect, the study finds that this rate would be 63.6% (compared to the historical average of 63.3%).

Exchange contracts and current account: the exchange rate gap

Full study (only in Portuguese) here.

- The study analyzes the recent growth dynamics of what it calls the “export exchange rate gap”, defined as the difference between the value of Brazilian exports recorded in the balance of payments and the exchange rate contract associated with export revenues.

- As the exporter can use its export revenues to make payments related to other balance of payments accounts, the export exchange rate gap cannot be analyzed in isolation from the exchange rate gap in other accounts. In fact, data from the Brazilian Capital Abroad (CBE) survey shows that a significant part of these revenues were used for payments abroad.

- To have a more comprehensive view of the inflows and outflows of resources in the country vis-à-vis their potential, the exchange rate gap for current transactions is defined as the aggregate of the exchange rate gaps for the trade balance and services and income accounts. This gap is much smaller than the export gap, suggesting that exporters have not accumulated such a significant amount of resources abroad that could be internalized in the future.

- **Exporters' accounts abroad**
  Full study (only in Portuguese) here.

  - Based on the study mentioned in the previous box, the BCB will publish a table (access here) along with the results of the CBE survey, with annual data (from 2019) on outstanding balances and flows in foreign deposit accounts of exporters residing in Brazil.

  - In addition to these accounts abroad, the table also presents the transactions that explain their change, specifying inflows into the account due to export revenue received directly from abroad (without exchange rate) and outflows due to payments for goods or services, among other expenses.

- **Recent dynamics of services inflation**
  Full study (only in Portuguese) here.

  - The study analyzes the recent evolution of consumer services inflation, presenting the main measures that the BCB monitors to better understand this component. Services inflation presents important differences in relation to other components: it is not directly affected by variations in the exchange rate and commodity prices, it has greater inertia than other components and is more sensitive to the output gap and, thus, reacts in a particular way and with lags to monetary policy.

  - Among the items analyzed, in addition to more traditional measures such as the headline services inflation (with a weight of 35.5% in the IPCA), underlying services inflation (21% of the IPCA) and services excluding air tickets (34.6% of the IPCA), alternative measures of services inflation are presented that are more sensitive to inertia (18.3% of the IPCA) and economic idleness (19.1%), according to the methodology already presented in previous IRs. Finally, special attention also deserves the inflation measure for labor-intensive services (6.1% of the IPCA), which, despite showing relevant dynamics, is based on a small portion of the IPCA, and, therefore, is more susceptible to fluctuations than other metrics. Because of this, the BC presented another box, a summary of which we also present below, which reweights the sub-items of service inflation according to the weight of labor remuneration in the production of each service.

  - The study concludes that services inflation decreased after its peak in 2022, but the pace of this disinflation is reducing. According to the analysis, this evidence corroborates the diagnosis presented in recent Copom minutes that a relevant part of the disinflation in services was due to the spillovers of disinflation seen in food and industrial goods, but that the continuity of the disinflationary process, now in its second stage, it will be more related to the labor market scenario and aggregate demand.

- **Services inflation reweighted by production factors**
  Full study (only in Portuguese) here.

  - Due to the limitation of the inflation measure for labor-intensive services due to their low weight in the IPCA, as mentioned above, this study proposes a new measure for the inflation of labor-intensive services (in addition to inputs and capital), which incorporates a broader set of IPCA sub-items. The study is similar to the Macro Vision – The weight of wages: a core measure that reweights the IPCA recently published by Itaú.

  - The reweighting methodology consists of identifying the relevance, based on the TRUs (Tables of Resources and Uses, National Accounts), of the remuneration of labor, capital and the cost of inputs in the formation of prices for each sub-item of services in the IPCA and then uses this information to construct inflation measures that reflect the relative importance of each of these factors.

  - Compared to headline services inflation (ex-airfare), the measure reweighted by intensity in the use of labor shows higher variation in recent quarters. According to the study, this behavior may, to some extent, reflect the recent dynamism of the job market. Furthermore, its recent behavior corroborates the view presented in the previous study that services inflation measures suggest, for the most part, a decrease in the pace of disinflation in recent quarters.

Output gap measures in Brazil

Full study (only in Portuguese) here.

- The BCB intended, through this analysis, to increase the transparency that permeates the central bank decision-making processes. To this end, different methodologies are presented to estimate the output gap, highlighting the high uncertainty in measuring this unobservable variable. Among the family of univariate models, 7 methodologies are described: quadratic trend with breaks, non-parametic trend, HP trend, L1 trend, modified HP trend, bandpass filter, Beveridge and Nelson. Regarding multivariate gaps, 5 methods are presented: production function with simple combination, production function with Areosa's approach, production function based on CBO USA, estimation based on Jarocinski and Lenza and estimation based on principal components.

- In conclusion, the set of measurements has a high amplitude, which reinforces the inherent uncertainty in estimating this unobservable variable. Even so, the high correlation between the different measures stands out.

Update of neutral real interest rate measures in Brazil

Full study (only in Portuguese) here.

- This study presents an update of several neutral real interest rate estimates for the Brazilian economy, obtained using different methodologies, and which can be considered in the monetary authority's decision-making process.

- The analysis concludes that, after reaching a minimum with the outbreak of the Covid-19 pandemic, most estimated rates have shown an upward trend. There was an increase in neutral rates based on the Focus survey, the Pre-Copom Questionnaire (QPC), interest parity and high and low frequency rates based on the product gap, while neutral rates based on NTN-Bs market rates discounted by the forward premium showed reduction movements. The neutral rates of the BC models showed relative stability.

- In the period considered, the average neutral real interest rate obtained with the different methodologies rose from 4.8% to 4.9%, while the median rose from 4.8% to 5.0%.

Update of small-sized semi-structural models

Full study (only in Portuguese) here.

- In this box, the BCB updated information on small semi-structural models, reestimating their parameters, using a sample that extends until the end of 2023, thus covering the pandemic period. According to the text, the estimated parameters had little change relative to previous versions.

- Among the main results, illustrated using impulse response functions, an increase of 1 p.p. in the Selic rate (for 4 quarters, followed by a behavior based on the Taylor rule) leads the IPCA to fall, reaching, accumulated in four quarters, an estimated maximum effect of 0.27 p.p. and 0.24 p.p., according to the aggregate and disaggregated models, respectively.

- A permanent depreciation of the exchange rate of 10% produces a maximum effect on the IPCA change accumulated in four quarters of approximately 0.96 p.p. and 0.87 p.p., according to the same models, respectively.

- In the case of the IS curve, a positive shock of 1% in the output gap (demand driven) causes an increase of 0.49 p.p. and 0.45 p.p. in IPCA inflation accumulated over four quarters, according to the respective models.

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